11/29/82 R5650-2

JEI REPORT

JAPAN ECONOMIC INSTITUTE

No. 45A

November 19, 1982

THE SERVICE SECTOR OF JAPAN'S ECONOMY

SUMMARY

With the administration pressing for negotiation of a multilateral regime for services under the General Agreement on Tariffs and Trade (GATT), it is important to understand the service sector of Japan's economy in order to follow the issues and problems as they develop. Several JEI Reports have already examined particular industries in the service sector, including banking (Council Report No. 43, December 21, 1979), consumer credit (JEI Report No. 41, October 22, 1982), food service (JEI Report No. 8A, February 26, 1982), distribution (Council Report No. 18, June 22, 1979), and tourism (JEI Report No. 42A, October 29, 1982). This JEI Report provides an overall perspective on the service sector as a framework for these reports as well as for future analyses of individual service industries. One important point often obscured in discussions but emphasized here is that services trade and the service sector of the economy are not entirely the same. The questions of exposure to international trade and government policy are also examined.

Introduction

This November the United States intends to propose a work program at the GATT ministerial meeting to result eventually in the establishment of an overall framework for services trade similar in concept to the existing GATT framework for merchandise trade. This new interest reflects the realization that the industrialized countries are experiencing a shift in economic structure toward services and that as these enterprises become more important in international trade they will present very different policy issues.

The first fact that must be recognized is that trade in services and the service sector are not the same. This is especially true for the United States. Services implies economic activities that do not produce physical products, although this is a rather nebulous concept and definitions differ somewhat from writer to writer. What is important here is that certain transactions in international trade which fall under the category of services do not correspond to any service industry in the domestic economy, for instance repatriation of profits from foreign direct investments and receipt of royalties from abroad. In 1981, receipt of income from U.S. assets abroad amounted to $90 billion of the total $130 billion in services receipts, and $53 billion of the total $87 billion in services payments. Fees and royalties added another $7 billion to receipts and $800 million to payments. On the other hand, there are significant service sector industries in Japan which have no involvement in international trade — such as rail and highway transportation, utilities and medical care.

Some of the interest in the United States in pursuing a GATT framework for services trade has been predicated on the sizable U.S. surplus in this sector, which appears to demonstrate U.S. strength in these industries. That view must be modified to take account of the incongruence between the service sector and services. When investment income plus fees and royalties are removed, the United States shows a small net deficit of $1.7 billion in 1981. The situation for Japan is explored in detail later in this report.

A partial rebuttal to this argument is possible, however. Since services are not physical goods, they must be sold where consumed. This means that a U.S. service export to Japan, hotel services for example, would either require the Japanese purchaser to travel to the United States, or an American investment in Japan. In the first case, the transaction will show up as a tourism export; in the second case as repatriation of investment earnings. Other services which fall in this category include most business services (law, accounting, management consulting, etc.) and finance. Alternatively, exports can take the form of franchising, as in the case of American fast-food restaurant chains in Japan, which show up as fees and royalties in the balance-of-payments data. Ideally, one could represent service sector trade by subtracting investment income from manufacturing investment and fees or royalties from transfer of manufacturing technology.[1] For the purposes of this report, it is sufficient to be aware that discussion of Japan's service sector and its involvement in trade is not the same as consideration of services trade as a whole.

A second point which should be emphasized is that the service (or tertiary) sector of the economy is very diverse. By definition it is basically every industry or activity that does not fall into the categories of agriculture, forestry, fisheries, mining or manufacturing. In the following analysis, this sector is first considered as a whole, after which the industries composing it are examined in more detail.

A Macroeconomic View

The relative role of the tertiary sector can be measured in a variety of different ways, two of which are used here. Table 1 shows the percentage of gross domestic product (GDP) originating in the tertiary sector and how it has changed over the decade of the 1970s. It would be helpful to carry the changes back farther in time, but the reporting of the sectoral breakdown changed in the late 1970s from net national product (NNP) to gross domestic product, which produces considerably different results and precludes a direct comparison with earlier periods.

As can be seen in Table 1, the share of the tertiary sector is high and has been rising. From 57.2 percent of total GDP in 1970, it rose to 65.4 percent by 1980, reflecting both a drop in the relative share of the primary sector (agriculture, forestry, fishing and mining) from 6.8 percent to 4.4 percent, as well as a drop in the manufacturing sector from 35.8 percent to 30.3 percent. Even though the data are not strictly comparable, the NNP data show that the rise in the share of the tertiary sector has been taking place since at least 1960. However, the pace of change may have slowed, since Table 1 shows little change in the relative share of the tertiary sector since 1975.

Table 2 provides a second measure, giving the relative shares of employment in the three sectors. Here there is no problem of changing measurement bases, so the comparison can be taken back farther. This confirms the trend seen in Table 1. From 44.3 percent of employment in 1960, the tertiary sector expanded to 65.4 percent by

The JEI REPORT (ISSN 0744-6489) is published weekly for $40 per year by the Japan Economic Institute of America, 1000 Connecticut Avenue, N.W., Washington, D.C. 20036. Second class postage paid at Washington, D.C. POSTMASTERS: Send address changes to JEI, 1000 Connecticut Avenue, N.W., Washington, D.C. 20036.

1980. Most of the change can be attributed to the decline in agricultural employment, as the primary sector's share fell from 33.8 percent in 1960 to 10.9 percent in 1980. Manufacturing, on the other hand, expanded somewhat from 21.9 percent in 1960 to 26.7 percent in 1970, and thereafter dropped slightly, slipping to 23.7 percent by 1980.

All industrial nations have undergone a shift of employment and output away from agriculture toward both manufacturing and services. The important new shift is from manufacturing to services, which in Japan occurred in the 1970s according to both Tables 1 and 2. This is what is referred to as the "post-industrial society", although the term is something of a misnomer since a large share of output and employment continues to be accounted for by the manufacturing sector.

It is also true that Japan has not progressed as far as the United States in the shift from manufacturing to services. Tables 3 and 4 provide a comparison of output and employment shares by sector for the two countries for 1980. Although both countries have approximately the same percentage of output originating in the primary sector, Japan has a much higher proportion than the United States in manufacturing and a smaller contribution from services. In Japan, manufacturing accounts for 30.3 percent of output compared to 21.7 percent in the United States, while services in Japan show 65.4 percent compared to 71 percent in the United States.

Employment provides a somewhat different picture (Table 4). Japan still has a higher proportion of employment in the primary sector (mainly agriculture) than the United States. The percentage in 1980 was 10.6 for Japan versus 4.5 for the United States. The proportion of employment in manufacturing is roughly equal, at 24.7 percent in Japan and 22.2 percent in the United States. In the tertiary sector, Japan again stands out, with employment representing a significantly lower 64.7-percent share than the United States' 73.3 percent.

The differences between the shares of output and employment among the three sectors implies wide variations in value added per worker, which are portrayed in Table 5. Indexing the economy as a whole to 100, Japan's primary sector looks very inefficient at 42, while manufacturing is above average at 123 and the tertiary sector close to average at 101. In the United States, the tertiary sector is also close to the average producing level of the whole economy at 97, but so is manufacturing at 98, while the primary sector is above average at 124. These figures should not be regarded as very precise, however, since the output of some service industries is notoriously difficult to measure and may be at variance with the method of collecting employment data.

Although Japan's tertiary sector is a smaller part of its economy than is the case in the United States (Japan is approximately comparable in structure to the United States in 1960), it does seem to be converging with the United States. The relative shares of the three sectors in the United States have shown little change in the 1970s; the tertiary sector was 69.9 percent of total GNP in 1970, only slightly below 1980's 71.0 percent. If the United States has passed through a transition phase and maintains its present structure for some time, and assuming the shift toward services continues in Japan, the gap may continue to close.

Part of the shift toward the service sector in Japan during the 1970s was a result of the prolonged recession following the 1973 oil shock and the permanent slowdown in the overall growth of the Japanese economy. With a dip in demand for labor in manufacturing (where employment dropped 7 percent from 1973 to 1978), occupations in the tertiary sector became more attractive. For example, there was a considerable rise in the number of small retail shops during this period. To the extent that the 1970s were

a response to the special economic conditions of the decade, the shift to services could slow down in the 1980s, although other studies suggest continued change.

In a study published by the Ministry of International Trade and Industry, Vision of Industrial Policy in the 1980s (in Japanese), employment in the tertiary sector is forecast to increase to 67.6 percent by 1990.[2] This represents a continuing shift, but at a much slower pace than in the previous decade. Other, somewhat earlier surveys anticipated a similar adjustment in the next 10 to 20 years.[3] It does seem likely that just as in other countries, more leisure time, higher real incomes and a change in the age structure of the population will continue to expand the tertiary sector's share of total employment and output.

A Microeconomic View

The different industries within the service sector have little in common. Tables 3 and 4 provide some breakdown of output and employment by these major diverse categories in a comparative framework for Japan and the United States. Table 3 shows that many of the industries have roughly the same share of total economic activity in both countries. The differences are relatively small and are most noticeable in the areas of construction (9.1 percent in Japan and 4.6 percent in the United States), wholesale/retail (12.4 percent in Japan, 16.1 percent in the United States), and government services (9.7 percent in Japan and 11.5 percent in the United States).

Table 4 provides a similar industry division for employment, which again shows some differences between the two countries. The United States has a higher proportion of employment in finance/insurance/real estate, government services, and "other", while Japan has a higher proportion in construction and the wholesale/retail industries. The result offers a rather different picture of industry productivity in the two countries. Table 5 gives GNP share/employment for the various industries. In general, the cross-national pattern of more and less productive industries is similar; service industries that are more (less) productive than the average for the economy are the same in Japan and the United States. However, the relative degrees of productivity are different; compared to the economy as a whole, the U.S. distribution industry (wholesale and retail trade) is less inefficient than Japan's, while construction and "other" services are less efficient in the United States.

Even the categories provided in Tables 3, 4 and 5 are rather broad. Table 6 provides a more detailed taxonomy of the tertiary sector, indicating some of the different activities that fall under each category. As can be seen from the list, not only is there a wide variance in output, but some industries are characterized as not-for-profit organizations (much of education, government services, postal services and hospitals). This presents obvious problems in measuring their output or understanding their motives and operational dynamics. A more important consideration is that government policy toward these industries is under the aegis of a number of government ministries and agencies. In those cases where a policy-making role vis-a-vis an industry is discernible, Table 6 lists the relevant ministries. This situation stands in direct contrast to manufacturing, where most (but not quite all) industries fall under the jurisdiction of MITI.[4] To the extent that Americans are familiar with the Japanese bureaucracy, their impressions are often formed by MITI, whereas other ministries have quite different goals, attitudes, procedures, and degrees of influence regarding the industries under their jurisdiction.

One implication of this divergence of goals is that the kind of consensus on growth policies that characterized manufacturing in the 1950s and 1960s has not been common in many other industries. In the distribution sector, for example, there has been a

conscious policy of protecting small shops from the inroads of large department stores or discount operations. In transportation, policies have often favored specific industries, but frequently coordination has been lacking to the extent that policies to assist one mode of transportation have conflicted with the goals for others (such as the simultaneous construction of parallel expressway and high-speed rail lines). In other cases, part or all of an industry is subject to the control of government-owned corporations (including rail transportation, postal services and airlines), a situation almost nonexistent in manufacturing (with the exception of cigarettes). With less coordination, the division of policy among many ministries, and the political pressures to protect small firms, a further shift toward the tertiary sector could imply a slowdown of productivity growth in the Japanese economy.

The Trade Connection

Japan has had consistently mounting deficits in services trade both globally and with the United States. If one subtracts investment income and fees and royalties from total services trade, the adjustment makes a considerable difference for the United States. In Japan, though, it works in the opposite direction, since Japan has a small net deficit on investment income and a larger deficit on royalties and fees. For 1981, adjustment for these items reduces Japan's services trade deficit from $13.6 billion to $11.6 billion. In fact, Japan runs a deficit in every category of services except revenue from international freight transportation.

Involvement in international trade also varies widely by service industry, and for many trade is nonexistent, as indicated in Table 6. There is no way for industries such as rail transportation, highway transportation, electric power, gas, water supply, retail sales or most government services to have any involvement in trade except through the presence of foreigners living or traveling in Japan. Some areas only generate small services receipts, including education (relatively few foreigners study in Japan), legal services (where strong barriers exist in many countries — including Japan), or accounting and management consulting.

Since often it is the purchaser and not the service that moves across national boundaries, even when barriers to entry limit the access of foreign companies, considerable trade can still take place since the purchasers of services do the traveling. One example is legal services, where despite barriers to entry, trade takes place when American companies in Japan use Japanese law firms and vice versa. This by no means negates the fact that the flow of services trade in both directions would be considerably larger in the absence of barriers to entry. In some cases, these barriers in Japan have become the subject of bilateral discussion or negotiation. In other cases, where trade and investment are permitted with little restriction, American companies have been very successful, as, for example, in the fast food industry. The problems that exist and the forms of trade that occur have been examined in previous JEI Reports dealing with specific service sector industries.

Conclusion

Even though the shift in structure away from manufacturing and toward services appears to represent a more advanced level of economic development, there is concern in both countries that in fact, many service industries (such as construction and distribution) are relatively inefficient. This implies that the shift may imply slower productivity growth for the economy as a whole. For Japan the problems are also seen in the context of policy making by relevant government ministries, whose varying goals and demands include in some cases strong political pressure to protect small, inefficient firms.

On the international side, Japan has consistently run deficits in its services trade, even if the data are adjusted to eliminate services trade that does not represent service industries. These deficits stand in great contrast to Japan's large surpluses in merchandise trade. Even if government policy is conceded to have been a factor in the success of Japanese manufacturing exports, the policy difficulties in the service sector may imply that Japan will not be able to duplicate that success.

Since the service orientation of the Japanese economy is expected to increase, and with it the potential for trade in certain service industries, the creation of a GATT framework is highly desirable. The lengthy, bitter dispute over bilateral commercial airline services and the potential friction over restrictions on legal practitioners stems in part from diverse industry structures and different intellectual assumptions about the nature of these industries. Neither country is necessarily wrong, but some international framework to assist in finding a common ground on which to agree is desirable.

Footnotes

[1]Kazuo Nukazawa, "Japan's Emerging Service Economy and the International Implications," pp. 43-47, suggests that even manufacturing investment income could be included as a legitimate service flow on the grounds that foreign direct investment represents primarily a transfer of management skills.

[2]Ministry of International Trade and Industry, 80 Nendai no Tsusan Seisaku Vision (Vision of Industrial Policy in the 1980s), p. 348.

[3]Nukazawa, pp. 12-18.

[4]The exceptions in manufacturing include shipbuilding (Ministry of Transportation) and pharmaceuticals (Ministry of Health and Welfare).

For further information, contact Edward Lincoln.

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Table 1

Gross Domestic Product by Sector

	Primary	Secondary	Tertiary
1970	6.8%	35.8%	57.2%
1975	6.0	29.9	64.1
1980	4.4	30.3	65.4

Note: Prior to 1970, the sectoral breakdown in Japanese statistics was done by net national product rather than gross domestic product, precluding a direct comparison.

Source: Prime Minister's Office, Japan Statistical Yearbook

Table 2

Employment by Sector

	Primary	Secondary	Tertiary
1960	33.8%	21.9%	44.3%
1965	25.3	24.6	50.1
1970	20.0	26.7	53.2
1975	15.6	25.6	58.9
1980	10.9	23.7	65.4

Source: Prime Minister's Office, Japan Statistical Yearbook

Table 3

Comparison of Japan and the United States:
Output by Industry - 1980

	Japan (shares in GDP)	U.S. (shares in GNP)
Primary	4.4%	6.5%
Secondary	30.3	22.5
Tertiary	65.4	71.0
Construction	9.1	4.6
Utilities[1]	2.9	2.6
Wholesale/Retail	12.4	16.1
Finance/Insurance	15.8	14.9
Transportation/Communication/Real Estate	6.9	6.3
Government Services	8.7	11.5
Other	13.8	13.1
Rest of World[2]	-4.2	1.8

Notes: [1]Electricity, gas and water supply.

[2]Import duties minus service charges on imports, plus statistical discrepancy. For the United States, the figure includes net factor income from abroad since the total is GNP and not GDP, but the impact is very small.

Sources: U.S. Department of Commerce, Statistical Abstract of the United States and Prime Minister's Office, Japan Statistical Yearbook.

Table 4

Comparison of Japan and the United States:
Employment by Sector
1980

	Japan	U.S.
Primary	10.6%	4.5%
Secondary	24.7	22.2
Tertiary	64.7	73.3
Construction	9.9	6.2
Utilities*	6.9	6.6
Wholesale/Retail	22.5	20.2
Finance/Insurance/Real Estate	3.5	6.0
Government Services	3.6	5.4
Other	18.1	28.8

*Includes transportation and communication in addition to electricity, gas and water.

Source: Same as Table 3.

Table 5

Implicit Productivity:
Value Added per Worker by Sector in Japan and the U.S.
1980

	Japan	U.S.
Total GNP (or GDP)	100	100
Primary	42	124
Secondary	123	97
Tertiary	101	97
Construction	92	73
Utilities*	142	135
Wholesale/Retail	55	80
Finance/Insurance/Real Estate	451	248
Government Services	241	213
Other	76	45

*Includes transportation and communication in addition to electricity, gas and water.

Source: Same as Table 3.

Table 6
Japan's Service Sector in Greater Detail

	Relevant Ministry	Involvement in International Trade?
Construction	MOC	yes (plant exports)
Utilities		
Electric Power	MITI	no
Gas	MITI	no
Water/Sewer	local	no
Distribution		
Wholesale	MITI	yes (trading companies)
Retail	MITI	no
Finance		
Banking	MOF, MPT*	yes
Insurance	MOF	yes
Securities	MOF	yes
Real Estate	MOC, NLA	yes (but minor)
Transportation		
Rail	MOT	no
Highway (truck/bus/taxi)	MOT	no
Air (domestic/international)	MOT	yes
Ocean (coastal/international)	MOT	yes
Communications		
Newspapers/Magazines/Books	-	yes (imports, few exports)
Telephone/Telegraph	MPT	yes
Television/Radio/Movies	MPT	yes (imports, few exports)
Postal Services	MPT	yes (but no competition)
Advertising	-	yes
Government Services		
Police	NPA	no
Fire	FDA	no
Administration	all	no
Other Business Services		
Engineering/Architecture	MOC	yes
Accounting/Auditing	MOF	yes (mostly imports)
Management Consulting/Forecasting	MOL	yes (mostly imports)
Legal Services	MOJ	yes
Other (cleaning, etc.)	-	no
Other Personal Services		
Recreation/Sports	MITI/MOE	no
Hotels/Restaurants	MHW	no (except through tourism)
Tourism	MOT	yes
Medical Care	MHW	no
Education	MOE	yes (imports, minor exports)
Other (haircuts, etc.)	-	no

Note: The abbreviations are:

MOC=Ministry of Construction
MOT=Ministry of Transportation
MOF=Ministry of Finance
MHW=Ministry of Health and Welfare
NPA=National Police Agency
MPT=Ministry of Posts and Telecommunications
FDA=Fire Defense Agency
MOE=Ministry of Education
NLA=National Land Agency
MOJ=Ministry of Justice
MITI=Ministry of International Trade and Industry

*MPT oversees the Postal Savings System.